DOCUMENT RESUME

ED 317 702 CE 054 118

AUTHOR Stern, Robert N.
TITLE Employee Ownership Plans. Background Paper No. 34.
SPONS AGENCY Department of Labor, Washington, DC. Commission on Workforce Quality and Labor Market Efficiency.
PUB DATE Sep 89
CONTRACT 99-9-4778-75-032-04
NOTE 55p.; In "Investing in People: A Strategy to Address America's Workforce Crisis" (CE 054 080).
PUB TYPE Information Analyses (070)

EDRS PRICE MF01/PC03 Plus Postage.
DESCRIPTORS Adults; Economic Opportunities; Employee Responsibility; *Employees; Employer Attitudes; *Employer Employee Relationship; *Fringe Benefits; Industrial Structure; Labor Legislation; Labor Relations; Organizational Development; *Ownership; *Participative Decision Making; Personnel Management; *Productivity; Retirement Benefits
IDENTIFIERS Employee Retirement Income Security Act; *Employee Stock Ownership Plans

ABSTRACT

Employee ownership through employee stock ownership plans (ESOPs) was first mentioned in federal legislation in the Regional Rail Reorganization Act of 1973. Since then, at least 19 pieces of federal legislation have been enacted that deal with employee ownership in some way, including the Employee Retirement Income Security Act (ERISA) and tax legislation. Among the results of such legislation have been the slight broadening of the holding of stock, the provision of an important employee benefit, and the ability of entrepreneurs to manage financial needs. These benefits have come without decreases in company performance, but there is evidence that increased performance is possible if ownership is coupled with participative decision making. To encourage employee ownership, the U.S. Department of Labor should (1) support the formation of state-level organizations to facilitate employee ownership and to help implement the necessary changes in labor relations; (2) make available information on Internal Revenue Form 5500C so researchers can study whether companies use employee ownership to replace pension plans or offer it as simply an additional benefit; and (3) develop a simplified ESOP document. Securities and Exchange regulations should give employee shareholders the same rights held by bondholders in firms of 500 or more employees. (53 references) (CML)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

ED317702

34. EMPLOYEE OWNERSHIP PLANS

Robert N. Stern

Cornell University

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

☐ This document has been reproduced as received from the person or organization originating it.

☐ Minor changes have been made to improve reproduction quality.

• Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

The author would like to thank Corey Rosen, Joseph Blasi and Frank Adams for helpful discussions of employee ownership issues during the preliminary stages of work on this report.

This project was funded under Purchase Order No. 99-9-4778-75-032-04 from the U.S. Department of Labor, Commission on Workforce Quality and Labor Market Efficiency. Opinions stated in this document do not necessarily represent the official position or policy of the U.S. Department of Labor, Commission on Workforce Quality and Labor Market Efficiency.

CE054118

34. EMPLOYEE OWNERSHIP PLANS

Robert N. Stern
Cornell University

The idea that employees of an enterprise who are not managers should have an ownership stake in their firms is not a new one in the U.S. Neither is the current practice strictly a product of new incentives which have dramatically stimulated employee ownership since the passage of the Employee Retirement Income Security Act (ERISA) in 1974. In this paper, a brief history of the employee ownership idea and its practice in the U.S. are presented along with a discussion of the presumed implications of having non-managerial workers become owners in their places of work. Theorists as well as managers have hypothesized positive effects of ownership for the individual, the firm and the nation as a whole.

After reviewing research concerning the effects of employee ownership, an evaluation will be made of the effectiveness of these organizational forms in achieving economic, social and political goals. There are several apparent problems with the current legislation and practice regarding employee ownership which might be changed in order to achieve unrealized but desired benefits. These changes are presented as a series of policy recommendations aimed at creating more equitable and simple administration of employee ownership plans, gathering the data which are really needed to assess the benefits and costs of Employee Stock Ownership Plans (ESOPs), providing information and assistance to firms interested in employee ownership, and increasing the likelihood of obtaining improved economic performance and labor relations outcomes

through the use of employee ownership plans in conjunction with worker participation in decision making.

A SHORT AND NOT SO GLORIOUS HISTORY

The first U.S. factory organized by producers on the basis of each person owning a single share and participating equally in firm decision making was among shoemakers in Baltimore in 1794 (Curl, 1980). Producer cooperatives were often formed by crafts workers seeking to maintain the autonomy and status of skilled craftsmen in the face of industrialization; through cooperatives, craft workers resisted the discipline and lost status which accompanied factory work (Shirom, 1972). However, a substantial number of cooperatives were designed explicitly as temporary organizations during labor-management conflicts. They were used as strategic tools to pressure employers into granting higher wages as factory production grew more prominent in the economy.

The temporary nature of some cooperatives and the ideological overtones of some few others (Grossman, 1943) led many analysts to view the cooperative form of production organization as unstable (Webb and Webb, 1920). In fact, cooperative forms of productive enterprise were organized as a result of general economic conditions and were often efficient forms of production for the circumstances of the time (Jones, 1977). These forms also created self control and autonomy for worker owners who collectively made decisions concerning the organization of work, compensation and firm policy (e.g., Jackall and Levin, 1984; Russell, 1985).

The first real plans through which employees came to own stock in their employing company appeared in the 1920's. By 1927 some 400 large corporations had these plans which usually provided for discounted buying of stock or low interest loans to employees to facilitate purchase of employers' stock. Some corporations such as National Cash Register, General Motors and Eastman Kodak provided the stock as an employee benefit without charge (Stern and Comstock, 1978). A particularly important aspect of these plans was that their use by non-managerial employees was apparently higher (estimated at 31 percent) than among managers (estimated at 8 percent) though managers held far greater numbers of shares on average (National Industrial Conference Board, 1928) because the plans were based on compensation levels just as many ESOPs are now.

The first theories discussing the effects of employee ownership of employer stock also appeared at that time. Employee stock ownership was posited to improve morale and productivity because employee owners would receive both short run returns in dividends and long run returns in increased value of stock. Adversarial labor relations were thought to decline because the different interests of workers and owners would become blurred. Workers would be participating in the capital formation process making their jobs more secure and integrating them into the economic system. Firm stock was thought to tie employee owners to the employer thus reducing turnover. Finally some managers saw the plans as a way to create an in-house market for stock (Foerster and Dietel, 1926).

Unfortunately, an assessment of these effects was not really possible because of the Great Depression. Between 1926 and 1932 over 60 percent of the plans were terminated (Davis, 1933). One study which was done in 1928 (NICB) concluded that the amount of money workers accumulated from the plans was too small to change work behavior. There was no visible incentive to increase output. Much of this difficulty was attributed to the length of time it took for stock to produce visible returns. Labor relations benefits were also impossible to assess adequately because the depression inflicted heavy losses on workers who had invested in stock. When the workers needed to draw on savings because of economic conditions, their stock was of course, concomitantly, worth much less than expected.

Most interesting for present concerns about employee ownership is that the presumed benefits and risks of current systems are the same. Managers and analysts expect higher productivity, better labor relations, less turnover and a greater appreciation from workers of the exigencies of firms operating in the marketplace. A recent public opinion poll (August, 1987) found that over 70 percent of a random sample of 1,000 Americans believed that people who work for an employee owned company, work harder, pay more attention to the quality of their work and are more concerned about the financial performance of the company than those working in companies not owned by their employees (NCEO, Sept./Oct., 1987).

The first successors to the plans of the 1920's were stock option and employee stock purchase plans which appeared in the 1950's and 1960's. However, stock option plans primarily benefited highly

compensated executives and several studies concluded that there was nothing motivational about providing stock options (Foster, 1973). The size of non-managerial employee holdings through purchase plans was again too limited both in breadth of participation and in size to be viewed as a force for changing behavior.

Though practical experience with earlier attempts at employee ownership of stock neither produced widespread holdings nor enough research to evaluate its effectiveness in improving firm performance or individual welfare and motivation, a number or analysts have argued that employee ownership is both an equitable and practical form for the U.S. economy. In a well argued book on the political and economic system, the prominent political scientist Robert Dahl makes what is essentially the main argument involving equity and the U.S. social system. Simply put, the egalitarian political system which so maintains our society as stable and participatory should be extended to economic enterprises as well. Members of firms, just as citizens of the society, should have a right to participate in the decision making of economic enterprises (Dahl, 1985).

Though his argument actually is elaborated much further, its implication is presumably the disruption of the legal structure of private property. However, this primae facia conflict with property rights only exists in the circumstance where the employees (i.e., citizens) of the organization are not also its owners. In theory, employee ownership should be accompanied by the same rights which ordinary shareholders possess through their ownership of stock. Social

justice, equity and democracy are the philosophical foundations upon which worker ownership of enterprise is proposed.

However, far more pragmatic arguments are commonly made for employee ownership. Louis Kelso's position has been that including all employees in the ownership of capital and their resulting participation in the rewards of the economy as both employees and owners, will enhance firm performance and simultaneously reduce inflationary and market distorting demands for ever increasing wages. Workers who receive income as stockholders will not be solely reliant on wage income. They will presumably work harder to increase their wealth and income through the shares they hold, and the necessity of constantly increasing wages will be reduced (Kelso and Adler, 1958; Kelso and Kelso, 1986).

The Honorable Senator Russell Long translated such arguments in more "down to earth," applied terms. If employees have a financial stake in capitalist production, they will worker smarter, have a better quality of working life and the U.S. economy will become more competitive in the world market. In helping enact 19 pieces of legislation promoting employee ownership while on the Senate Finance Committee, he continually asserted that "Employee owners typically become more motivated and more dedicated. Work quality and workplace creativity increase, productivity and competitiveness improve; absenteeism and turnover decline" (BNA, 1987).

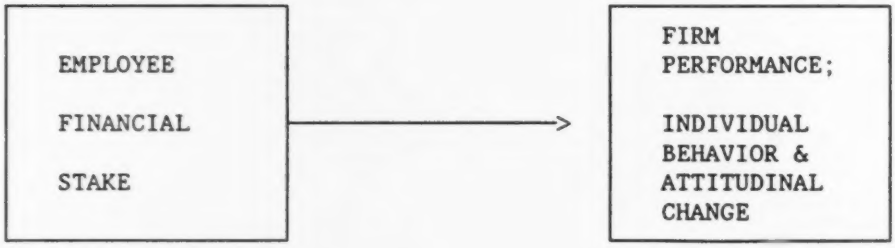
Many economic, sociological and psychological researchers have been more reserved about these presumed benefits. They have not only sought to empirically determine the effects of employee ownership on individual and firm performance, but have also posed a somewhat modified

explanation as to why there should be any effects of employee ownership in the first place.

ALTERNATIVE CONCEPTIONS OF EMPLOYEE OWNERSHIP

The managers and analysts of the 1920's, 50's, 60's and advocates such as Kelso seem to be suggesting that the creation of a financial stake (albeit a large enough one) for non-managerial employees will in itself create increased commitment to job and firm, resulting in changed worker behavior. In other words, the financial participation in capitalism alone is thought to produce the positive practical outcomes of employee ownership. Figure 1 illustrates this theory which proposes a direct linkage between financial stake and expected outcomes.

FIGURE 1: FINANCIAL EFFECTS MODEL



Some evidence supporting parts of this model has appeared. For example, Rosen et al. (1985) find a relationship between the size of the company contribution to the ESOP and satisfaction with the ESOP,

organizational commitment, job satisfaction and intention to leave the company. These strong effects were not attributable to other characteristics of the ESOP or the firm. However, the actual size of the ownership stake in terms of the proportion of the company owned by employees did not produce statistically significant relationships with employee attitudes. Financial contribution, but not the ownership stake itself seemed to matter in this study. These results, the history of employee ownership, and psychological and social theory suggests an alternative mechanism for the creation of most positive outcomes.

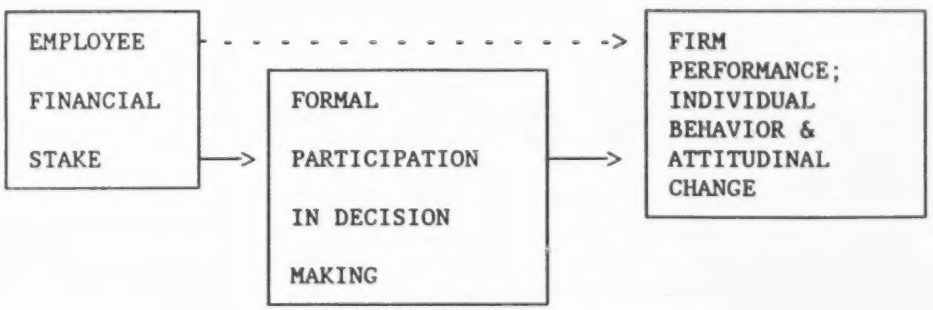
In producer cooperatives the individual owners share in the responsibility for making decisions about the organization of work and the firm. They see themselves as entrepreneurs who have acted collectively to accumulate sufficient capital to run an enterprise. Behaving as entrepreneurs means making economic decisions about the firm, and sharing in the resulting risks and benefits. In employee ownership cases involving employee buyouts of factories, Whyte (1984) and his colleagues found that workers shifted their views of social justice and their expectations about participation in firm decision making. They expected to exert more influence as owners over the operations of the firm (e.g., Hammer and Stern, 1980). Numerous studies have found that workers expect to participate more in decision making though they tend to want such opportunities for participation to focus on the work process rather than broad firm policy and investment (see Levine and Strauss, Paper #35a). These workers often see work process issues as more germane to their daily lives and simultaneously doubt

their ability to make managerial decisions regarding finance, investment and marketing.

Participation with ownership gives workers the opportunity to make their work more meaningful with the resulting positive benefits to productivity, commitment and work behavior. Changed expectations without the opportunity for participation may create conflicts over the right to participate. The worker buyout cases at South Bend Lathe and Hyatt-Clark illustrate the conflict which may result. The participation plans at Weirton Steel and a variety of other sites (Quarry et al., 1986), show the importance of the alternative view.

Regardless of the exact expectations over the form which participation should take, the research and theory suggest that the positive effects of employee ownership function through the accompanying process of worker participation in decision making. When participation is not included, the expected positive outcomes will be diminished if not eliminated all together. Figure 2 illustrates this theoretical perspective. The effects of financial stake are mediated by the

FIGURE 2: PARTICIPATORY EFFECTS MODEL


EMPLOYEE FINANCIAL STAKE
FORMAL PARTICIPATION IN DECISION MAKING
FIRM PERFORMANCE; INDIVIDUAL BEHAVIOR & ATTITUDINAL CHANGE

extent of participation in decision making. The theory however, does not imply that participation without ownership is sufficient to generate sustained positive outcomes. Its effectiveness is dependent on the changing expectations and financial stake of individuals through ownership. Many worker participation plans show short term effects which fade (see again Levine and Strauss, Paper 35a). Among the problems is the demand that workers exert extra effort in participation without additional compensation. Participation may become an expansion of job definition, a kind of work "speed-up." Often workers expend energy on participation only to find that their opinions are not listened to and group suggestions are not implemented. Some worker participation is severely constrained in terms of the subjects over which participation takes place. Entrepreneurs, investing in an enterprise, exerting control over its actions and benefiting from improved performance sustain their own interest and efforts over a much longer span. Research evidence on the effects of employee ownership plans must be evaluated with respect to these alternative conceptions.

FORMS OF EMPLOYEE OWNERSHIP

Employee ownership of corporate stock generally takes place in two forms: stock held in trust and direct ownership of shares. The most prominent of these is stock held in a trust for the benefit of employees. The primary forms are pension funds and ESOPs. (As pension fund stock is not thought to significantly affect the performance of work, and pensions are covered in papers #32 and #39, the focus here is

upon ESOPs.) The General Accounting Office (GAO) estimates that in March 1986 there were approximately 4800 ESOPs active in the U.S. There were an additional 2,400 non-ESOP stock bonus plans which may be viewed as similar to the form of ESOP which does not involve leveraging or tax credits. In early 1989, the National Center for Employee Ownership (NCEO) estimated that approximately 10,000 such plans now exist and cover 10 million workers. With 1983 Internal Revenue Service (IRS) data, the GAO reported over 7 million employees participating in ESOPs with total plan assets of about $18.7 billion. Median assets per participant were estimated at $5,226 though the distribution of participant assets across types of ESOPs are very different (GAO, 1986).

ESOPs are enormously flexible in terms of financial structure and administrative rules. They are roughly classifiable into four types, the most numerically dominant of which is the tax credit ESOP often called TRASOP or PAYSOP. These were established by using tax code provisions which permitted credits for capital investments and later for a percentage of total payroll so long as the credited amount was used to make contributions to an ESOP. This credit represented the primary form in which the Federal government subsidized the formation of employee ownership through ESOPs. The GAO report estimates that 26 percent of the 1983 plans were of this form, but these covered 90 percent of participants and represented 90 percent or more of the foregone tax revenue associated with ESOPs. The report estimates approximately $11.8 billion in lost revenue over the 1977-83 period for tax credit ESOPs. Some studies indicate that 50-60 percent of Fortune 1000 companies have established tax credit ESOPs (Blasi, 1987). This type of ESOP has had

the lowest per worker account balance of the general types and was associated with the fewest opportunities for worker participation in decision making. However, these credits were ended in 1986, and the effect on maintenance and establishment of ESOPs was uncertain until recently when a number of large public corporations established plans of the leveraged type.

The other forms of ESOPs fall directly under ERISA and consist of leveraged plans, plans which are not leveraged but are structured so they could be and those which are strictly used as employee benefits. The first two types permit the use of employee ownership as a device for raising capital in a relatively inexpensive fashion. A corporation may set up a trust which borrows funds and uses them to purchase stock from the firm. Thus, the employer receives loan proceeds in exchange for shares which are held in a trust ordinarily controlled by management and the lending institution.

Such ESOPs are encouraged first by the tax code which permits the employer to repay the loan through the trust and deduct both the principal (up to an amount equal to 25 percent of compensation) and interest (without limit) as fringe benefit costs. Second, the commercial lenders are permitted to deduct 50 percent of the interest they earn on ESOP loans. The practice has been to reduce loan interest rates somewhat encouraging both corporate establishment of ESOPs and lender interest in making loans for the purchase of employer stock. Third, corporations are permitted to deduct the value of dividends paid on ESOP shares if the funds are used to repay the loan or are distributed in cash to employee shareholders. Fourth, owners of

corporations wishing to reduce their holdings may sell shares to employees through an ESOP and may roll over tax obligations by reinvesting the proceeds of the sale in other securities. This facilitates the transfer of ownership of private firms from founding entrepreneurs and their families to employees and is an opportunity for estate management with business continuity.

Commercial loans to ESOPs in 1987 were estimated at $5.5 billion with over $3 billion of it going to establish the Avis and Health Trust ESOPs (NCEO, 1988). Leveraged ESOP loans totaled $6.5 billion in 1988 with 50 of the loans amounting to more than $10 million each. Public corporation ESOPs were most prevalent in this group. In January 1989, Proctor and Gamble borrowed $1 billion for establishment of a leveraged ESOP (NCEO, 1989).

This form of ESOP covers only about 6 percent of plan participants, but is more likely than other forms to be used for buyouts of failing companies and by founding entrepreneurs who wish to retire or reduce their financial stake in their firm. Leveraged plans can acquire large ownership shares more quickly than non-leveraged plans. The GAO placed the tax revenue loss for this type and the nonleveraged form at between $.2 and $1.5 billion annually (GAO, 1986). The wide range represents the reasonable possibility that firms could obtain similar tax advantages by using mechanisms other than the ESOP form.

The nonleveraged form, similar to a stock bonus plan, simply gives stock to employees through trust accounts as a benefit. Here, employers may contribute up to 15 percent of compensation to the plan or 25 percent if there are carryovers from previous years. Approximately 3

percent of participants are covered by this form (GAO, 1986) which grants a tax deduction for the corporation only for the cost of the employee benefit itself.

Analysts of ESOP legislation and administration also argue that it is important to separate the discussion of ESOPs in public and private corporations. Public firms have largely used the tax credit form in the past, and they are subject to different rules of administration. For example, public companies must pass through the voting rights on allocated shares of stock to the employees for whom it is being held. Private firms need not do this except on major decisions including merger, consolidation, sales of substantial corporate assets, recapitalizations, reclassifications, liquidations and dissolution when the plan itself has 10 percent or more of its holdings in employer stock. Thus, the nature of participation by employee owners in public and private firms may be very different.

The termination of the tax credit ESOP form through the 1986 Tax Reform Act was anticipated as a disincentive for public firms to invest in ESOPs. However, the data for 1988 and early 1989 show that if anything, the number and size of plans in public firms is increasing. One reason is the ability of firms to deduct the amount of dividends paid on shares if the proceeds are used to repay the ESOP loan. Thus, companies have been able to place preferred convertible shares of stock with relatively high dividend rates in the trust. The result is the substitution of a deductible expense for a non deductible one which both pays back the loan and provides an employee benefit. Further, companies

have been able to use loan proceeds to purchase common shares from the market, thus bringing more shares under control of the firm.

The practice has also been accompanied in public firms with the explicit substitution of ESOP plans for other employee benefits. For example, a recent *Business Week* article reported on Boise Cascade, Ralston Purina and Whitman each deciding to eliminate post retirement medical plans and telling employees to use proceeds from their ESOP stock to purchase insurance. Polaroid workers obtained an ESOP but took a 5 percent wage cut and lost company contributions to a 401(k) savings plan (May 15, 1989:118-119). The issue of benefit substitution, addressed later, suggests the need for research explicitly aimed at determining what employees are giving up in exchange for ESOP stock.

Direct worker ownership of stock, as opposed to a trust or ESOP form, was used in some of the first few worker buyouts of factories scheduled for closure such as the Library Bureau in Herkimer, New York, Saratoga Knitting Mill in Saratoga Springs, New York and the Vermont Asbestos Mine in Lowell, Vermont. However, buyout cases represent a very small portion of the total number of firms with employee ownership. The National Center for Employee Ownership estimates such cases at only 1-2 percent of the total, and direct ownership in buyouts has been replaced largely by use of the leveraged ESOP form. The GAO survey of 3,700 ESOP firms finds 4 percent saying they used the ESOP to save a failing firm (1986).

On the other hand, direct ownership through producer cooperative arrangements remains a viable option for employee ownership. Under this form, all members of a firm own equal numbers of shares of stock

(usually one share) and act jointly in making decisions for the firm. Alternative financial structures such as internal account maintenance are also used. The most successful group of cooperatives in the world, in the Mondragon region of Spain, uses this alternative method.

Historically, the number of producer cooperatives in the U.S. has been rather small (Aldrich and Stern, 1983), but prominent U.S. examples include plywood firms in the Pacific Northwest, taxicab companies, garbage collection and reforestation companies. Though the current number of producer cooperatives is estimated to be only a couple of hundred, they have been shown to have high levels of productivity, to pay higher wages than comparable non-cooperative firms in the industry and to produce a more satisfying, motivating work situation. The earnings which are returned to members are not a tax obligation for the firm and are taxed only as income to individual worker owners (avoiding the double taxation issue which dividend payments create except under the ESOP conditions discussed previously).

Cooperatives seem to be able to provide more jobs for a given level of capital than other firms. They have been shown to be at least as ·oductive as comparable conventional firms and to require fewer supervisors to monitor work (Jones and Svejnar, 1982; Jackall and Levin, 1984; Russell, 1985; Gunn, 1984). However, they also tend to be smaller than the efficient scale of operations for numerous industries. As a result they often appear in the retail and service sectors. Further, cooperative forms of organization have suffered from insufficient levels of reinvestment in capital equipment due to incentives to maximize member short run income. Perhaps more important in describing their

limitations, is their existence in an economic system which does not support them as an organizational form. Their incentives are not always consistent with current practices of conventional firms and they lack the supporting institutions which conventional firms can utilize (Aldrich and Stern, 1983).

CURRENT ISSUES

The current thrust of employee ownership is in the direction of the stock trust ownership form which merits primary attention here. Policies promoting employee ownership in the U.S. have sought to achieve two goals which have previously been difficult to promote simultaneously. One is to stimulate economic growth through enhanced firm performance and the other to promote social equity by broadening the distribution of the ownership of wealth (Quarry and Rosen, 1986). Such positions are visible in the legislative history of employee ownership beginning in 1974 with statements from numerous Senators and Representatives (Blasi, 1988). One oft cited statement supporting employee ownership came from former President Reagan, who argued that, "Our Founding Fathers well understood that concentrated power is the enemy of liberty and the rights of man...And since in any society social and political power flow from economic power, they saw that wealth and property would have to be widely distributed among the people of this country." (Reagan/ Bush Committee, 1980).

In pursuit of these goals, ESOP legislation was specifically drafted to seek to broaden the ownership of corporate stock, provide more funds for capital formation and to improve the performance of

sponsoring firms (GAO, 1986). The evaluation of research on employee ownership which follows is structured to address current knowledge on these issues. The primary emphasis is on how employee ownership has affected firm performance, meaning productivity, profitability, employment levels and individual work behavior. Does it produce more satisfying jobs for American workers and do they feel an increased sense of participation? Has legislation been successful in broadening the distribution of wealth in the form of more widespread holding of corporate stock? Does employee ownership contribute to capital formation? At the same time, the creation of employee ownership through ESOPs has affected issues related to individual employee benefits and to shareholder rights. Policy must ultimately be concerned with these as well.

EVALUATING FIRM PERFORMANCE

The analysis of ESOP firm performance moved beyond simple case analysis after 1978. Over the past ten years substantial information has accumulated about firm performance regarding profitability, productivity and growth. The difficulty involved in reporting research results with confidence is that the studies have tended to be limited in crucial ways. One significant problem involves small sample sizes and sampling bias. Several studies used samples of firms that had been identified in the press, congressional hearings and reports of other researchers. When larger samples became available, studies faced the problem of responses gleaned from successful firms only or primarily from those willing to take the time to report on their plans. The

likelihood of bias toward successful firms was high. In all cases, the brief period of time of operation of most ESOPs, has made evaluation of long run effects difficult.

Some researchers compared employee owned firms to industry averages; others drew matched samples of firms for comparison but were not always careful about matching by specific enough industrial categories. Only three studies have used a pre and post employee ownership plan analysis. These studies are more sophisticated than earlier work; the most recent one by the GAO and an analysis of publicly traded firms by Bloom (1985), inspired more confidence in the current state of knowledge. The 1986 study by Quarry and Rosen, sponsored by the National Center for Employee Ownership (NCEO), and a book by Rosen et al. (1985), provide greater insight into issues such as job satisfaction, the importance of how much stock is held and how much participation in decision making is involved.

Promoters of employee ownership enthusiastically received the 1978 study by Conte and Tannenbaum which reported that in a sample of thirty firms with some form of employee ownership, the ratio of pretax profits to sales was 50 percent higher than for conventional firms in the same industries. They also found that the higher the proportion of firm equity owned by workers, the greater the profitability. However, the 98 firm group from which the 30 responded was identified from media coverage, professional journals and colleagues; the comparison sample was drawn from available annual reports of public corporations. The results, though encouraging were not statistically significant.

In order to remedy the problems of sampling and reliability, a second study was undertaken which expanded the original 98 by 101 firms. A matched sample was drawn from Dun and Bradstreet and the same measure of profitability was used. This time no differences were found between the employee owned firms and the matched sample (Tannenbaum, Cook and Lohman, 1984).

One study matched eight ESOP with non-ESOP firms in the electronics industry. Although ESOP firms were found to have somewhat higher productivity (net sales per employee) and profitability (net profit/sales; net profit/capital; net profit/net worth; net sales/net worth) than the non-ESOP firms, no statistical significance of the differences could be shown (Hamilton, 1983). Another, a much publicized productivity study, argued that ESOP firms showed greater productivity growth than industry averages over the 1975-79 period. No significance statistics were reported and the response rate to the survey was only 7 percent (Marsh and McAllister, 1981). A similar pattern is repeated in several other studies. Employee owned firms are shown to have some greater productivity, profitability or growth (Rosen and Klein, 1983) than industry averages or a matched sample, but no statistical significance for the differences is shown. Blasi (1988) reports on 26 studies including those already mentioned which suggest that ESOPs improve firm performance. However, each of the studies is limited by the methodological problems which initially plagued this line of research.

Bloom (1985) studying tax credit ESOPs in public corporations carried out a study with adequate controls, a matched sample of firms

and a before-after design. He found that ESOP firms did seem to have greater productivity, but was able to show that this was a result of more productive firms choosing ESOPs in the first place. Profitability advantages seem to be explained by other factors such as capital investment. He concluded that ESOP firms did not show improved performance because of ESOP plans, but his conclusion also shows that publicly traded ESOP firms do as well as others. Employee ownership did not hurt firm performance.

In 1986, the NCEO (Quarry and Rosen) reported on a matched sample, before and after study of 45 ESOP firms. Each firm was matched with five or more non-ESOP companies of approximately the same size within the same industry and geographic region. Firm performance was examined by comparing matched firms and ESOP companies in the period before the ESOP was established, in the period after establishment and the ESOP firms were compared to themselves in the before and after periods. Growth in employment and sales were examined. Firms provided information on management philosophy regarding employee ownership, use of tax advantages, size of contribution to the plan, employee participation in decision making, communications with employees about the plan and plan features. The study also evaluated the effects of changes in management, voting rights, board representation for workers, company size and worker attitudes about the plan.

Post ESOP performance was 6.5 percent higher in sales growth and 7.1 percent higher in employment growth for the ESOP companies. The study finds that two thirds of the ESOP companies did better than their

matched comparison group on the two measures. The rates of growth actually increased substantially in the after ESOP period.

However, the most interesting findings appeared when an attempt was made to explain why such differences existed. Correlations with the other independent variables showed that the only consistent predictor of performance differences was the degree of formal worker participation in decision making in the firm. A management philosophy promoting employee ownership for reasons other than tax advantages was also related to performance improvements, but such philosophies were associated largely with the implementation of accompanying participation plans. In a multivariate analysis, no predictors other than employee participation through participation groups and employee perception of influence in decision making remained significant for all performance measures.

In an attempt to examine the effect of participation, the interaction between performance level and amount of participation was analyzed. It showed that those ESOP firms with very low levels of participation or no participation plans actually did worse on performance measures than the matched samples. Those firms with moderate or high levels of worker participation in decision making did much better than the matched samples in both the post plan period and in comparing the differences between pre and post plan performance. The data further show that positive employee attitudes concerning the ESOP are associated with better firm performance (Quarry and Rosen, 1986).

The stream of firm level performance research currently ends with the study released by the GAO (1987). Originally stimulated by a request from Senator Long to examine the tax and performance record of

ESOPs, the study used data from IRS files to examine matched pairs of ESOP and Non-ESOP firms before and after establishment of the plans. Samples were drawn of firms with plans established during periods from 1976-77 and 1978-79 and examined for two years before the plan and three years after its establishment.

Tests for after tax profitability effects revealed statistically nonsignificant differences except for the second year after plan establishment in 1976-77 firms, favoring the ESOPs. Other tests with nonsignificant effects favored non-ESOP firms in four out of five cases. Tests of productivity change using value added in a ratio with total costs again produced nonsignificant differences though the direction favored non-ESOP firms. That is, the evidence suggests that ESOP firms did no better and no worse than conventionally owned firms.

The GAO also attempted to examine the covariates of improved performance for the ESOP firms. A sample of 1,100 ESOP firms was surveyed in 1981, with a 77 percent response rate (GAO, 1987:12). The type of ESOP, existence of voting rights, assets per participant, percentage of the company owned by the ESOP, industry and increases in participation after establishment of the plan showed no relationship to improvement. Only the level of worker participation in decision making was related, producing a positive relationship to productivity performance.

The GAO survey also showed that participation levels had not changed in most firms after establishment of the ESOP. Twenty seven percent indicated some increase but among this group, three quarters indicated that the increased participation was informal rather than

institutionally structured (1986:41). On the other hand, a 1983 New York Stock Exchange study found firms with ownership plans to be 25 percent more likely than others to have formal worker participation plans, and four times more likely to have a quality circle program. Research on participation in the absence of employee ownership shows that positive effects of participation on productivity have not been sustainable over long periods of time. Initial performance improvement tends to disappear after 6 months to two years (See again Levine and Strauss, Paper 35a). Participation coupled with ownership seems to be maintained over a longer period though no systematic studies have been attempted.

The ten year line of research on the firm level performance effects of employee ownership provides two critical conclusions.

1) Employee owned firms do as well as conventionally owned firms in productivity, profitability and employment growth and performance. (This finding is particularly important given the initial criticism that employee ownership was a desperation attempt temporarily to save failing firms.)

2) Performance superior to conventional firms may be shown when employee owned firms include formal participation in decision making along with the financial stake of ownership. (This finding is consistent with both the literature on participatory democracy and the position taken that the benefit of the stock itself may be so deferred and in such small amounts initially, that behavioral effects will not occur [U.S. President, 1985]). Participation makes the financial stake salient.

BEHAVIOR AT WORK

There is little doubt that managers expect and proponents hope for improved work behavior from employees under employee ownership. The GAO survey reported that 66 percent of firms including three quarters of the leveraged and tax credit ESOPs believed that employee ownership would produce increased employee morale. Thirty-six percent expected reduced employee turnover, and 14 percent decreased absenteeism. Another 8 percent indicated that the expected increase in the commitment of workers to the firm might help them avoid unionization.

Journalists, politicians and researchers have long argued that employee owners will "work smarter." They are expected to be more highly motivated, more committed to the firm and more likely to take actions designed to improve firm performance. Research on these issues however, has been less systematic than that examining overall firm performance. Much of it consists of anecdotal reports by journalists or researchers who happen to notice something interesting. With a few notable exceptions, the systematic studies have examined one or two firms rather than large samples. At the same time there is a certain consistency among the reports which suggests that attitudinal and behavioral changes exist.

The first systematic studies of attitudes and behavior focused upon cases of worker buyouts of factories. Some of these studies involved direct stock ownership cases and others ESOPs, but there appeared to be consistency among them. There was an initial burst of enthusiasm for the ownership plans including increased motivation, lower turnover, less material loss due to poor quality production and increased commitment to

the firm (see for example, Whyte, 1979). This honeymoon period was followed by the disappearance of many of these effects and in some very prominent cases, dramatic increases in labor-management conflict.

Researchers looking at these cases generally found that worker expectations had changed as a result of ownership and the financial sacrifice which was often made in saving a plant. For the most part employee owners expected an increase in their influence in firm decision making. At the same time, there was a desire for increased management influence and skill (Hammer and Stern, 1980) as workers sought competent management to ensure the economic viability of the plant. The apparent contradiction is resolved by recognizing that non-managerial employees wanted to influence the work process and perhaps personnel decisions but not firm strategies on marketing or firm investment decisions.

Traditional managers however, often failed to recognize the change inherent in having shareholders working in non-managerial positions inside the firm. They often did not think about participation, and the turbulence of saving a firm through employee ownership, made recognition of the required change in management practice more difficult. These results again pointed to the necessity of implementing some form of worker participation plan which would acknowledge employees as owners.

Job satisfaction and firm commitment were also examined by a variety of case study researchers. Kruse (1984) reviewing some dozen studies summarizes the literature to that time. Support for increased job satisfaction due to ownership was simply not evident. The cases which found increased satisfaction often failed to control for other factors and those which did attempt multivariate analysis found that

satisfaction was not a result of ownership. Some employee owners did indicate satisfaction with the idea that a financial gain through ownership was possible, but most felt no sense of ownership per se. Satisfaction levels between owners and non-owners within the same firm tended to be the same.

Kruse's own study of two ESOP firms finds no improvement in satisfaction due to the ESOP. Searching for an explanation for low satisfaction levels led him to find that thwarted expectations about being treated better and having more information about the firm were probably responsible.

Results regarding increased sense of individual commitment to an organization are far different. Here, though the evidence is somewhat mixed, the bulk of it shows that employee ownership is associated with increased feelings of commitment to the firm and decreased intention to leave. The two most thorough studies using control group comparisons are most interesting because they examine cooperatives rather than ESOPs. Both Russell's work on scavenger (garbage collection) coops (1985) and Rhodes' study of plywood coops (1978) find higher levels of commitment (and satisfaction) than for comparable conventional firms. Rhodes found that turnover and grievance rates were lower, though no differences were found in absenteeism, lateness or accidents. She found that the increased commitment level was closely associated with perceived participation in firm decision making. A much earlier study of these cooperatives had found a similar relationship (Bellas, 1972).

The most comprehensive study to date is that reported by Rosen et al. (1986) in which 2800 employees in 37 ESOP companies completed surveys on job satisfaction, organizational commitment and turnover intentions. These data were examined with regard to both firm and ESOP plan characteristics. A substantial majority of workers indicated that owning stock led them to feel more committed to the firm particularly for financial reasons. Two-thirds also indicated that they thought they would stay longer as a result of owning stock. However, less than 50 percent felt that they worked harder, enjoyed their work more or were more cooperative because of owning stock. Less than 30 percent felt that owning stock had increased their influence in firm decision making.

The study found that the positive effects on satisfaction, commitment and turnover were significantly related to a positive management philosophy about employee ownership (it wasn't just a financial tool or a fringe benefit) and to the size of the company contribution to the ESOP (as a percentage of wages). The proportion of company stock owned, voting rights and increased stock value were not related. Communication about the ESOP was associated with some decreased level of turnover intention. Firm characteristics were unrelated to these variables with the exception of the well documented negative relationship between turnover and unionization. An analysis controlling for firm and plan characteristics shows that 25-35 percent of the variance in these three attitudes was explained by company contribution and ownership philosophy.

An examination of perceived and desired worker influence in decision making in these firms showed that worker perceptions of

influence were positively associated with satisfaction and commitment. Employee owners indicated that they wished to actively participate (at least have their opinions asked) about social events, work process and compensation. They were least satisfied with their level of participation regarding compensation and the hiring of managers and supervisors. Some interest in participating in company policy decisions was indicated, but the desire for participation largely focused on the work itself.

In a comparative case analysis of 15 firms overlapping with the Rosen et al. study, Quarry et al. (1986) used interviews and observation to discuss the effects of ownership. In the most successful of these firms they found attitudes and performance to be related to the implementation of some participatory mechanism along with ownership. The establishment of such mechanisms was largely a function of the views of top managers that employee ownership was central to the identity of the company and not simply a financing tool.

The other behavior thought to be related to employee ownership is absenteeism. Here, studies are sparse, but essentially reinforce earlier arguments. A detailed case study by Hammer et al. (1981) of an employee buyout examined absenteeism behavior both before and after the implementation of ownership. No changes in the overall level of absenteeism were found, but employees did shift their reasons for being absent from unexcused to excused categories. The change seemed to be related to a social or peer group pressure effect which has been identified in several studies.

An important second piece of research compared three pairs of stores involved in the creation of the O & O and Superfresh groceries in Philadelphia. These companies were created in a union initiated plan to prevent the closing of A & P stores. Under the plan, participation in decision making was to be implemented in the conventionally owned Superfresh stores and would be initially included in the O & O cooperatives (Hochner et al., 1988) Granrose et al. (1985), in early work on this study, compared worker and firm outcomes in the coop stores with two Superfresh stores with participation and two which had not started the participation plans at the time of the study. Absenteeism was significantly lower in the coop and conventional stores then in the conventional quality of worklife plan stores. Turnover was much lower in the coop than either of the other pairs. Among the conventional stores, the pair with participation alone had higher turnover than the traditionally run store. Though local circumstances may explain these findings, they are consistent with the idea that participation works best with ownership; it is harder to obtain and maintain effects of participation alone.

Large sample comparative studies of absenteeism in employee owned firms have not been carried out. The evidence so far suggests that there may not be much reduction in absenteeism as this behavior does not seem to be directly related to the financial stake involved in ownership of stock.

BROADENING HOLDINGS OF STOCK

The policy objective of broadening the holding of stock in the U.S. through employee ownership has been given considerable weight but relatively little attention. The rhetoric of many studies of ESOPs is that such an effect is inevitable as employee ownership plans spread and that the result will be a more equitable distribution of wealth and a more democratic society.

The concentration of wealth in the holding of corporate stock is apparent in a number of reports. The GAO study (1986) shows that only 19 percent of American families own stock either directly or through a mutual fund. The wealthiest 10 percent of households own 90 percent of corporate stock with the wealthiest .5 percent owning nearly 46 percent.

ESOPs and direct employee stock holding amounts to less than 1 percent of the ownership of corporate stock. However, among employees in such firms shareholding is widespread. The GAO reports that 71 percent of employees in ESOP companies own stock. That is, the structure of the plans naturally broadens the holding of stock. Obviously, all members of a cooperative own shares. Thus, employee ownership does meet the objective of redistributing wealth in terms of stock holding.

That employee ownership encompasses such a small proportion of the economy led the GAO report to conclude that the amount of redistribution attained through ESOP legislation has been rather expensive given the lost tax revenue. However, the largest tax subsidy, through the tax credit ESOP, has been eliminated. The Federal government provided a stimulus to permit experimentation demonstrating the effects of employee

ownership. The remaining tax advantages are far less costly and they may be used to raise investment capital as well as to permit the continuation of firms whose founding owners wish to retire. The same tax benefits are available through other financial mechanisms, suggesting that the continued maintenance of current tax treatment is sensible. The cost is relatively low, substantial opportunities facilitating firm financing are provided, and the distribution of wealth is inevitably broadened. The difficulty is that this broadening will represent only a very small change unless employee ownership is implemented in a substantially larger number of firms and with somewhat larger holdings per participant. In addition, employee stock ownership through trusts has created other dilemmas.

INDIVIDUAL BENEFITS AND RISKS

ESOP stock is treated as an employee benefit with plans established under the jurisdiction of ERISA. A number of analysts have criticized the law regarding ESOPs because ERISA protections afforded workers regarding diversification and some prohibited transactions under other benefit plans are not enforced with regard to these plans. Most notable is that ESOPs are permitted to invest completely in employer securities which leaves the employees' stake dependent on the fortunes of a single company rather than a diversified portfolio. Should the stock represent the employee's entire retirement benefit, a potentially high risk situation is created. The worker becomes dependent on the corporation for both employment and retirement income. Regulations now permit those reaching age 55 with at least 10 years in the plan to direct

diversification of 25 percent of account holdings deposited after 1986. However, this provision is very limited protection for plan participants. The value of stock which they may seek to diversify at age 55 is still based on the previous ESOP investment in the employer.

An ESOP also can engage in the normally prohibited transaction of acquiring stock from a "party in interest," in this case the employer or majority stockholders. This exemption permits the ESOP to use loan proceeds from the interested party to acquire stock. Without these exemptions, ESOPs could not function as now structured; many practical incentives for their establishment would be eliminated.

In addition to the possible imprudence of investing largely in employer securities, the fiduciaries who oversee the stock trusts may retain dual loyalties by being company officials or individuals hired by management. On occasion fiduciaries have been indemnified by insurance from corporate assets (Blasi, 1988). Protections of ERISA again have been structurally abridged.

The underlying point is that employees take extraordinary risk with ESOPs. If such benefits are being given in exchange for other benefits with less attached risk than more intense consideration must be given to the employment relationship plan members face. If many firms are acting in a pattern similar to that described in the Ralston Purina, Polaroid and other cases, then corporations are gaining substantially by reducing costs and placing risk on employees. A thorough assessment of the extent of trade-off among benefits types particularly regarding ESOPs becomes critical to evaluating this form of employee ownership. Should employees find themselves dependent on a firm's stock market performance

for a substantial portion of future welfare, disruption in labor relations and individual performance seem likely. At a minimum, employees taking on such risk should be afforded some influence in firm decision making.

ESOP PARTICIPANTS AS SHAREHOLDERS

The benefits issue is intimately tied to the manner in which ESOP participants are treated as shareholders. Analysts have discussed this issue in terms of both shareholder rights and the administration of the stock trusts. Ordinary shareholders are entitled to information about the company and its finances and have the ability to vote common and other certain classes of stock. Employee owners are treated differently than ordinary shareholders; they do not receive these same rights and protections regarding information disclosure which are afforded others by the Securities and Exchange Commission.

The problem is compounded by the treatment of workers in voting shares of stock. The financial benefit of ownership can be separated from the rights of control offered investors in ordinary corporate securities. The funds used and/or borrowed to establish the ESOP are part of the company's operating capital. An ordinary investor has a right to know if not make a decision about such a transaction. Plan actions may result in the dilution of stock value or the sale of a company.

A central dilemma of the voting question hinges on the management of allocated and unallocated shares within the trust. Allocated shares may be voted by trustees according to the instructions of participants

so long as the participants make an independent judgement free of employer influence. Plan documents should specify procedures for directing trustees and procedural prudence must be observed (BNA, 1987).

The voting of unallocated shares is particularly crucial in the case of acquisition attempts where trustees must determine the tendering of shares in the face of an offer. In highly leveraged ESOPs, the majority of shares held by the trust will not have been allocated to accounts because such an allocation occurs only as the ESOP loan is repaid. Unfortunately, the situation regarding voting or tendering of unallocated shares remains unclear. In February, 1989, the Department of Labor opinion regarding Polaroid indicated that trustees must vote unallocated shares independently. Trustees are advised to act in the long term interest of plan participants as participants and not as employees (NCEO March/April, 1989). Should trustees vote unallocated shares in the same proportion as instructed by plan participants' regarding allocated shares or should the interests of future participants and stock which will be allocated to current participants be subject to a completely independent judgement by the trustees? Though the issues over which employee owners must have voting rights are more restricted in private firms, the voting rights question is general to both public and private cases.

The psychology underlying this situation is apparently one in which the ESOP stock is seen as a gift or purely an employee benefit; the worker owners are not treated as investors or given ordinary shareholders' rights. Managers see the plans as containing shares which may be controlled strategically as in the defense Polaroid mounted

against the acquisition attempt by Shamrock Holdings. This situation makes the broadening of wealth through stock distribution objective somewhat problematic. Employee owners are treated as a different class of owners. When plans are drawn up, employees are not given details of the proposed transaction and have no ability to question or challenge the action. Clarification of the management of voting stock is needed given the differences between ESOPs and other benefit plans holding shares of stock on behalf of employees.

A COMMENT ON LABOR RELATIONS

One presumed benefit of employee ownership which has gone largely unexplored is the nature of labor relations under ownership plans. Some managers have argued that these plans are a device for avoiding unions (GAO, 1986) or for making existing unions unnecessary (Stern and Comstock, 1978; Kruse, 1984).

Evidence accumulated thus far does not sufficiently address the labor relations issue, but labor unions began with very skeptical views (Stern and O'Brien, 1977) and many have remained skeptical. The labor movement itself continues to debate the merits of employee ownership largely because experiences have been so highly varied and the implications of employees becoming firm owners are so ambiguous (LRR, 1985).

Debate centers upon the uncertain role which unions play in employee owned firms and in worker participation schemes. Some prominent collective bargaining settlements have included employee stock ownership in exchange for deferred or reduced compensation. Employee

ownership should lead to greater labor-management cooperation whether in organized or unorganized contexts. Cooperation in the form of participation seems to be necessary to capture employee ownership benefits. However, the intense conflicts experienced at South Bend Lathe, Hyatt-Clark and the Rath Packing Company as well as other firms testify to the difficulty unions may face. Adverse economic results due to declining share value and firm performance may have a negative impact on both labor-management relations and worker motivation. Working out labor's position as labor rather than owner under these plans may require outside assistance and considerable shifting in traditional adversarial thinking.

IMPLICATIONS FOR NATIONAL POLICY

Since employee ownership through ESOPs was first mentioned in the Regional Rail Reorganization Act of 1973, there have been at least 19 pieces of Federal legislation enacted that deal with employee ownership in some way. The most critical pieces involve ERISA under which these defined contribution plans fall and tax legislation particularly in 1984 and 1986 which altered the tax treatment of ESOPs. The result has been the slight broadening of the holding of stock, the provision of an important employee benefit, the ability of entrepreneurs to manage financial needs and a number of other effects outlined in the preceding discussion. These benefits have come without decreases in firm performance, but the evidence argues that increased performance is possible if ownership is coupled with participation in decision making.

1) Stimulating State Level Technical Assistance

Government legislation established the general legitimacy of employee ownership and stimulated the substantial growth in the number of ESOPs which has occurred. However, the tax and administrative requirements pertaining to ESOPs are substantial. Around this growth sector of the economy, a variety of external legal, financial and accounting expert consultants have developed practices. The assistance available privately for initiating and financially structuring plans is substantial, but relatively expensive. The continuing necessity that a valuation be placed on stock also requires the retention of independent consultants, particularly for private firms. At the same time that the consulting help and diffusion of information needed on the financial aspects of employee ownership has appeared, there has been a noticeable lack of outside professional help available to deal with changed work relations and worker participation.

The social, psychological and work restructuring side of employee ownership largely has been left to non-profit organizations such as the National Center for Employee Ownership and the Industrial Cooperative Association or to academic researchers. Perhaps the importance of participation and the rethinking of labor relations was unrecognized or the idea was viewed as unimportant or idealistic. Often, participation is a secondary consideration relative to financial issues. However, the research evidence on improved organizational performance demands attention to this aspect.

Assistance with employee ownership has been provided from one additional source to which our attention should be turned. A number of

state governments, in seeking to retain and attract industry to their states have developed legislation and expertise in employee ownership which has tended to recognize the importance of both the social and financial aspects of the issue. A few states quickly discovered that in order to use employee ownership as a viable economic weapon in countering employer arguments to leave a state because of high costs, poor labor relations or low productivity, they had to learn to work on labor-management cooperation. Most state economic agencies have substantial contacts with labor and management. The few state agencies which have developed expertise in employee ownership have disseminated information, organized training seminars and conferences which bring together those with experience and those with interest, and provided technical assistance to firms in implementing employee ownership plans on a practical day-to-day basis.

California, Michigan, New York and Wisconsin have established programs aimed at assisting with employee ownership. New Hampshire and New Jersey also have statutes requiring state agencies to provide technical assistance to employee buyouts of closing plants. The New York program is seen as the leading model of what might be done. These states plus Maryland, Massachusetts, Delaware, Pennsylvania and Washington have reporting requirements designed to facilitate tracking of employee owned firms. Illinois, Michigan, New Hampshire and New York have also funded public education programs on employee ownership. Seven states have laws specifically treating cooperatives (Ivancic and Logue, 1986).

The problem with the current state effort is that it has largely been directed at saving threatened plants. Such an approach means that technical assistance is provided for feasibility studies and low interest loans may be provided to save jobs. Experience with implementation of employee ownership is being collected but the effort is focused too narrowly. The positive effects on firm performance, state, and national economy should be drawn from employee ownership in general rather from plant closing economic development strategies. The small proportion of ESOPs established to save failing plants include some notable success stories but many more failures. The ESOP strategy in the trucking industry has been notoriously unsuccessful at saving firms.

The Federal government cannot mandate participation schemes in employee owned firms though some incentives might be developed encouraging their establishment. However, the Department of Labor could assist in stimulating employee ownership aimed at obtaining performance, financing and distribution of wealth effects by supporting the formation of state level organizations to facilitate employee ownership and to help implement the fundamental changes in labor relations which may be necessary.

Such a strategy would take advantage of local expertise and put responsibility for stimulating employee ownership into state rather than Federal agencies. Relatively low levels of funding would be required as one or two full time staff members could manage information dissemination and conference organization to create a network of individuals and firms with employee ownership experience. Funding

authorization could mandate dual responsibility for providing assistance on both financial and participation aspects. Thus, the element not currently provided by private sector consultants would be available. More detailed technical assistance might be encouraged from state funds. For example, in New York a university sponsored program called Programs for Employment and Workplace Systems received seed monies to begin operation as a low cost source of help in establishing labor-management cooperation in the context of employee ownership, profit sharing and other innovative cooperative schemes.

Such programs are an opportunity for government to promote labor-management cooperation in a context which seems to have high potential payoff. It is an opportunity to say that employee ownership might be more than a simple fringe benefit; the ownership of capital can be broadened and employees are provided with the chance to participate as owners. The government would be able to stimulate the development of the organizational programs needed to turn the potential productivity and firm performance gains available through employee ownership into practical outcomes.

Further, the existence of state infrastructure for employee ownership might act in a countercyclical fashion with respect to deteriorating economic conditions. A mechanism would be available for considering the economic feasibility of using an employee buyout strategy, and productivity might be improved through the implementation of both ownership and labor-management cooperation. Under economic stability or growth, such a state resource would continue to stimulate

both broadened ownership and the improved firm performance available through employee ownership plans.

2) Assessing the Individual Benefit

One of the critical questions addressed by the GAO report was whether or not the lost Federal tax revenue was justifiable given the functioning of ESOPs. In a sense, this macro economic question ignores the firm and individual level issues of cost and benefit which have been raised. One immediate concern of labor unions and analysts as the number of plans grew was whether or not this employee benefit was replacing other current benefits. Unions were particularly concerned that pension plans were being abandoned in favor of less secure ESOPs to the benefit of managers and the detriment of workers.

Anecdotal evidence appears on both sides. Some cases exist where pension plans were given up or other benefits foregone. However, many cases are reported where employee ownership is simply an additional benefit. Both the GAO report and the ESOP Association have reported this finding. How often is the explicit trade off that has been made by unions in airlines, automobiles, trucking and other industries of wages for stock, made implicitly in other cases? Some analysts argue that ESOPs are established to avoid the difficulties of managing defined benefit plans (Blasi, 1988), a view supported by the *Business Week* report.

These questions have not been adequately addressed by current research, and finding answers may be impeded by current reporting systems for pensions and benefits. Data produced by the government

report individual coverage by types of benefits. In order to truly assess the effects of ESOPs or any form of benefit on total benefits and to understand the role of ESOPs in corporate strategy, data on fringe benefits by firm must be made available. The Department of Labor could probably provide such information by using data provided on the IRS 5500C form to examine the proportion of compensation provided through each type of benefit and wages. Such reorganization of the data permits a better assessment of the firm and individual level costs and benefits of employee ownership through stock trusts. If such information is already collected, the cost of reorganizing the analysis is minimal. Otherwise, changes in the reporting form are required. A series maintained over time is necessary to see how firms shift their mix of compensation forms in relation to alternative benefits.

3) Simplified ESOP Instruments

ESOP plans may be relatively expensive to set up. Given the current legal and administrative complexities firms must hire outside legal and accounting help to design plan instruments and complete necessary application procedures. The cost may inhibit small firms from establishing employee ownership plans.

Current policy regarding pension plans permits small firms to complete standardized documents to set up a uniform pension plan. In such small firms, ESOPs are likely to be effective in producing productivity and behavioral benefits because the organizations are small enough to give workers a perception of substantial influence. They can more easily see the consequences of individual action with respect to

firm performance. The Department of Labor should develop a simplified ESOP document which would permit firms under 15 or 20 employees to establish plans at a relatively low initial administrative and legal cost. However, such a form provides only a limited incentive in some cases because of the substantial costs involved in periodic valuation of the shares.

4) Shareholder Rights under Employee Ownership Plans

One of the difficult areas in which policy intervention may be justified is the manner in which employees and employee stock are treated with respect to shareholder rights. If securities and benefit law is to be interpreted to allow these situations, then some provision permitting employees to review plans particularly in the case of leveraged buyout schemes seems appropriate. Further, the relationship between participants and fiduciaries with respect to instructions on voting shares must be clarified. The change might be accomplished by first extending to employee shareholders the same rights extended by SEC regulations to bondholders in firms of 500 or more employees. Such protections are the same as those afforded investors in public corporations. Second, the relative independence of fiduciaries from employers' influence should be affirmed.

However, there is great risk inherent in such changes. The movement toward equity in treatment might in fact reduce employer incentives to establish ESOPs in privately held firms. The transactions here which often involve a principal owner selling his interests to the employees (60 percent of leveraged plans) or raising capital (26 percent

of leveraged plans) might be inhibited by having to reveal information about firm finances and individual benefits, and the possibility of challenges by prospective employee shareholders. Thus, establishing a socially just and investor protected set of shareholder rights for ESOPs might jeopardize the growth in the number of such plans. Interestingly, this issue is not relevant to the direct ownership, cooperative form as individuals have rights to participate in decisions and jointly establish the rules for obtaining, selling and managing shares for their collective benefit.

Though questions might be raised regarding vesting provisions, direct voting rights, repurchase mechanisms and other ESOP issues, they seem less serious at this point than the overall form which the share ownership is taking and the voting of unallocated shares on major issues. The policy goal of broadening wealth is being managed in a less than equitable manner. Broadened ownership is being managed less to the benefit of the new "owners" than it could be. Employee owners are treated more as employees than owners. Perhaps such a system explains some of the inability of stock ownership to produce performance effects in the absence of participation. The cultural expectations and meaning of property ownership are not being reinforced or promoted by the current legal and financial structure regulating ESOPs.

CONCLUDING COMMENT

Perhaps the most important aspect of government policy regarding the promotion of employee ownership is that it conveys to the public and particularly to those who create and manage organizations, the message

that employee ownership is a legitimate and appropriate form of organization for economic enterprise. Numerous public opinion polls show general support for the idea that people who work in a firm should have an ownership stake in it (though some evidence suggests that owners of private firms have trouble entertaining the idea of workers owning company stock [NCEO, 1988]). The idea of employee ownership is entirely consistent with American values and holds the potential for improved organizational performance and individual welfare.

However, that promise has met only partial fulfillment. The problem appears to reside in the limited salience to employee owners of the financial stake they receive. This investment in stock is normally of small size and its seems distant from a direct relationship to work behavior. The benefits of ownership on firm performance and individual commitment, satisfaction and behavior occur when the ownership stake becomes salient through its treatment as a "real" ownership stake. That is, effects are seen when worker owners receive adequate information about the organization and the value of their investment, and when they obtain the opportunity to participate in the decisions about managing the firm. This is no more than the ordinary entrepreneur receives from his/her own investment and risk taking activity.

We have been enormously short sighted to believe that the performance effects would occur in the absence of the same incentives which the capitalist form of economy has relied upon to stimulate its growth and success. Long term expected results appear unlikely when the benefit accrues largely to the former owner(s) of the firm.

The cooperative form provides an important lesson here because such benefits and risks are directly relevant to cooperative owners. However, cooperatives have suffered because they have some difficulty in organizing joint decision making structures as they grow. Organizational governance may become the crucial problem for such firms after adequate management and financial resources have been developed. They also face some economic incentives (which may be avoided by proper structuring) leading away from adequate investment in new capital equipment. Within the U.S., cooperatives exist in a generally unsupportive environment without institutional mechanisms to sustain them as a broadly accepted form of business organization. The employee stock ownership form has the potential to avoid the collective decision problems and economic disincentives by grafting the broadened ownership onto the existing financial and governance structure of the capitalist firm.

However, a shift in thinking is required. Having owners working within a firm means that traditional management-labor adversarial relationships must be altered. Managers must think about and use power differently then in traditional firms. Employee shareholders must be viewed as a legitimate stakeholder group demanding better performance from the firm and acting to obtain it. Such a shift in managerial practice is difficult and may discourage some private entrepreneurs from using this organizational form, but employee stock ownership is entirely consistent with the shift toward cooperative labor-management relations which is being promoted as a necessity to make American firms more competitive (e.g., Kochan et al., 1986).

REFERENCES

Aldrich, Howard and Robert N. Stern. "Resource Mobilization and the Creation of U.S. Producers' Cooperatives, 1835-1935." Economic and Industrial Democracy 4(1983): 371-406.

Bellas, Carl. Industrial Democracy and the Worker Owned Firm. NY: Praeger Publishers, 1972.

Blasi, Joseph R. Employee Ownership Through ESOPs: Implications for the Public Corporation. NY: Pergamon Press, 1987.

Blasi, Joseph R. Employee Ownership: Revolution or Ripoff? Cambridge, MA: Ballinger Publishing Co, 1988.

Bloom, Steven M. "Employee Ownership and Firm Performance," Ph.D. dissertation, Department of Economics, Harvard University, (1985).

Bureau of National Affairs. Employee Ownership Plans. Rockville, MD: BNA, 1987.

Conte, Michael and Arnold Tannenbaum. "Employee Owned Companies: Is the Difference Measurable?" Monthly Labor Review, 101(July, 1978): 23-28.

nte, Michael and Derek Jones. "In Search of a Theory of the Formation for U.S. Producer Cooperatives: Tests of Alternative Hypotheses." Proceedings of the 37th meeting of the Industrial Relations Research Association (1984):377-384.

Curl, John. History of Work Cooperation in America. Berkeley, CA; Homeward Press, 1980.

Dahl, Robert A. A Preface to Economic Democracy. Berkeley, CA: University of California Press, 1985.

Davis, Eleanor. Employee Stock Ownership and the Depression. Ann Arbor, MI: Edwards Brothers, Inc., 1933.

Farrell, Christopher and John Hoerr. "ESOPs: Are They Good For You?" Business Week, (May 15, 1989): 116-122.

Foerster, Robert F., and Else H. Dietel. Employee Stock Ownership in the United States. Princeton, NJ: Princeton University Press, 1926.

Foster, Kenneth. "How Cost Effective are Stock Options?" Compensation Review 2(April, 1973): 11-18.

General Accounting Office. "Employee Stock Ownership Plans: Interim Report on a Survey and Related Economic Trends." report GAO-PEMD-86-4BR. Washington, D.C., GAO, 1986a.

General Accounting Office. "Employee Stock Ownership Plans: Benefits and Costs of ESOP Tax Incentives for Broadening Stock Ownership." report GAO/PEMD-87-8. Washington, D.C.: GAO, 1986b.

General Accounting Office. "Employee Stock Ownership Plans: Little Evidence of Effects on Corporate Performance." report GAO/PEMD-88-1.Washington, D.C.: GAO, 1987.

Granrose, Cherlyn, Eileen Appelbaum and Virendra Singh. "Saving Jobs Through Worker Buyouts: Economic and Qualitative Outcomes for Workers in Worker Owned, QWL, and Non-QWL Supermarkets." Proceedings of the 37th annual meeting of the Industrial Relations Research Association (December, 1985):196-204.

Grossman, J. "Cooperative Foundries." New York History, 24 (April,1943): 196-210.

Gunn, Christopher. Workers' Self-Management in the United States. Ithaca, NY: Cornell University Press, 1984.

Hammer, Tove Helland and Robert N. Stern. "Employee Ownership: Implications for the Organizational Distribution of Power." Academy of Management Journal 23(1, 1980): 78-100.

Hochner, Arthur, Cherlyn S. Granrose, Judith Goode, Elaine Simon and Eileen Appelbaum. Job Saving Strategies: Worker Buyouts and QWL. Kalmazoo, MI: W. E. Upjohn Institute for Employment Research, 1988.

Ivancic, Catherine and John Logue. "Employee Ownership and the States: Legislation, Implementation and Models." Kent, OH: Kent Poplar Press,1986.

Jackall, Robert and Henry Levin. Worker Cooperatives in America. Berkeley, CA: University of California Press, 1984.

Jones, Derek. "The Economics and Industrial Relations of Industrial Cooperatives in the United States, 1791-1939." Economic Analysis and Workers' Management 11(1977): 295-317.

Jones, Derek and Jan Svejnar. Participatory and Self Managed Firms: Evaluating Economic Performance. Lexington, MA: D.C. Heath, 1982.

Kelso, Louis O. and Mortimer Adler. The Capitalist Manifesto. NY: Random House, 1958.

Kelso, Louis O. and Patricia Hetter Kelso. Democracy and Economic Power. Cambridge, MA: Ballinger Publishing, 1986.

Kochan, Thomas, Harry Katz and Robert McKersie. The Transformation of American Industrial Relations. NY: Basic Books, 1986.

Labor Research Review. "Workers as Owners." Midwest Center for Labor Research (Spring, 1985).

Marsh, Thomas R. and Dale McAllister. "ESOPs Tables: A Survey of Companies with Employee Stock Ownership Plans." Journal of Corporation Law, 6(Spring, 1981): 521-623.

National Center for Employee Ownership. "Worker Cooperatives." The Employee Ownership Report, 7(May/June, 1987): 1,8.

_____. "NCEO-BNA Poll Shows Strong Popular Support for Employee Ownership." The Employee Ownership Report 7(September/October, 1987): 1,3-4.

_____. "ESOP Loans Soar in 1987." The Employee Ownership Report 8(March/April, 1988): 1-2.

_____. "Why Aren't There More ESOPs? New Data Suggests Limits to Growth." The Employee Ownership Report. 8(March/April, 1988): 3,5.

_____. "Leveraged ESOP Transactions Reach $6.5 Billion in 1988." The Employee Ownership Report. 9(January/February, 1989): 1,9.

_____. "Labor Department Issues Mixed Signals on ESOPs as Takeover Defense." The Employee Ownership Report. 9(March/April, 1989): 3.

National Industrial Conference Board. Employee Stock Purchase Plans in the United States. NY: NICB, 1928.

New York Stock Exchange. People and Productivity: A Challenge to Corporate America. NY: Stock Exchange Office of Economic Research, 1984.

Quarry, Michael, Joseph Blasi and Corey Rosen. Taking Stock: Employee Ownership at Work. Cambridge, MA: Ballinger Publishing Co. 1986.

Quarry, Michael and Corey Rosen. "Employee Ownership and Corporate Performance." Oakland, CA: National Center for Employee Ownership, 1986.

Reagan/Bush Committee. Memo, October 31, 1980.

Rhodes, Susan. "The Relationship Between Worker Ownership and Control of Organizations and Work Attitudes and Behaviors." Report to the Employment and Training Administration, U.S. Department of Labor, 1978.

Rosen, Corey and Katherine Klein. "Job Generating Performance of Employee Owned Companies." Monthly Labor Review, 106(August,1983): 15-19.

Rosen, Corey, Katherine Klein and Karen Young. Employee Ownership in America: The Equity Solution. Lexington, MA: Lexington Books, 1985.

Russell, Raymond. Sharing Ownership in the Workplace. Albany, NY: SUNY Press, 1985.

Shirom, Arie. "The Industrial Relations Systems of Industrial Cooperatives in the United States, 1880-1935." Labor History 13(Fall, 1972): 533-551.

Stern, Robert N. and Philip Comstock. Employee Stock Ownership Plans (ESOPs): Benefits for Whom? Ithaca, NY; ILR Press, 1978. Key Issues No. 23.

Stern, Robert N. and Rae Ann O'Brien. "National Unions and Employee Ownership." New York State School of Industrial and Labor Relations, Cornell University. Ithaca, NY: mimeo, 1977.

Tannenbaum, Arnold, Harold Cook, and Jack Lohman. The Relationship of Employee Ownership to the Technological Adaptiveness and Performance of Companies. Ann Arbor, MI: Institute for Social Research, 1984.

U.S. President. The President's Tax Proposals to the Congress for Fairness, Growth and Simplicity. Washington, D.C.: U.S. Government Printing Office, (May, 1985).

Webb, Sidney and Beatrice Potter Webb. The History of Trade Unionism. London: Longmans, Green & Co., 1920.

Whyte, William F. "Employee Ownership: Lessons Learned." Proceedings of the 37th meeting of the Industrial Relations Research Association (December, 1984): 385-395.